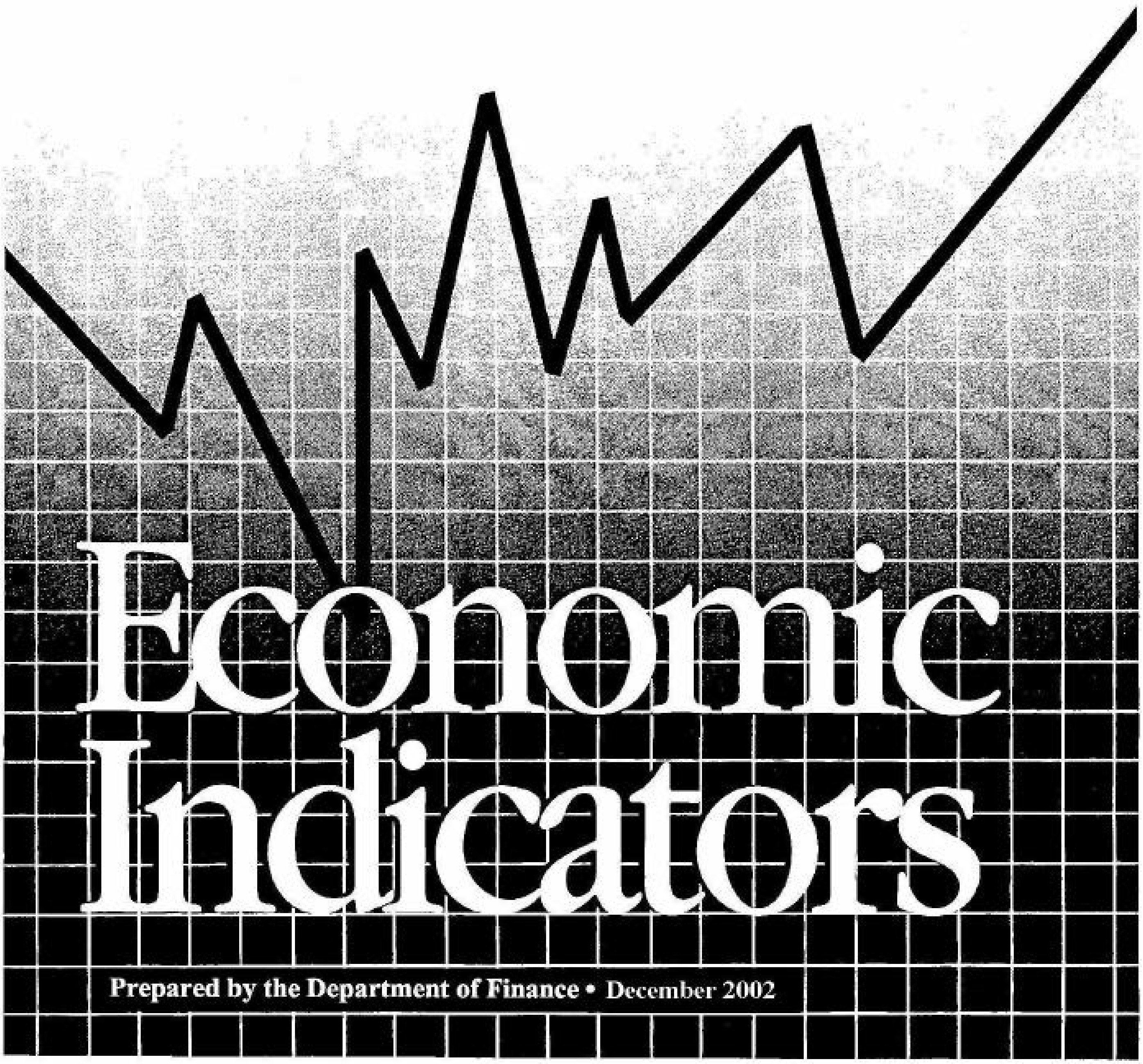


Economic Indicators

Prepared by the Department of Finance • December 2002

The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.

This report is also available through the Internet on the Montgomery County Web Page: http://www.montgomerycountymd.gov

For questions regarding this report, please contact:

David Platt
Chief Economist
Montgomery County Department of Finance
255 Rockville Pike, Suite L-15
Rockville, Maryland 20850

Phone: (240) 777-8866
Fax: (240) 777-8954
Email: David.Platt@co.mo.md.us

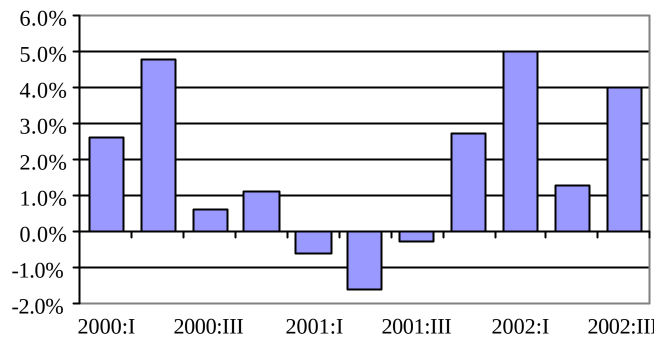
ECONOMIC OVERVIEW

During the first three quarters of 2002, the national economy continued its recovery and expansion. The double-dip recession that was a possibility during the latter half of 2001 and early 2002 had not occurred. However, while the economy continued to expand during the third quarter of 2002, albeit at a slow and uneven pace, there are indicators that the economy will remain sluggish during the remainder of this year and into the first quarter of next year. Three factors have contributed to such sluggishness: business and consumer attitudes, employment situation, and volatility of the stock market. While those factors cast a pall on the economic expansion, historic low interest rates and quiescent inflation remained the foundation of a potentially solid and sustainable economic expansion.

In spite of the volatility of the stock market, weak business and consumer sentiment, and the employment situation, the economy grew for the fourth consecutive quarter between July and September 2002. While the 4 percent growth in real gross domestic product (GDP) during the third quarter 2002 was slightly above market expectations, the economy continued to expand against the backdrop of a potential war with Iraq, the continued fight against international terrorism, and uncertainty about corporate malfeasance and future earnings. Regardless of weak sentiment about the future economic environment, the consumer and the government sector continued to be major contributors to the growth in GDP. Of the 4 percent real growth, consumer spending on durable goods was responsible for almost 60 percent of the growth with government spending a distant second. After two consecutive quarters of real growth in business investment largely attributed to the change in inventories, business investment turned negative during the third quarter. Declines in non-residential investment continued to be a drag on the economy.

According to the most recent data, the economic growth during the fourth quarter slowed from the moderate pace of the third quarter. The Conference Board's coincident index, a measure of current economic activity, increased a modest 0.1 percent during the first two months of the fourth quarter and has been relatively flat since June.

CHANGES IN REAL GROSS DOMESTIC PRODUCT



SOURCE: Bureau of Economic Analysis, U. S. Department of Commerce

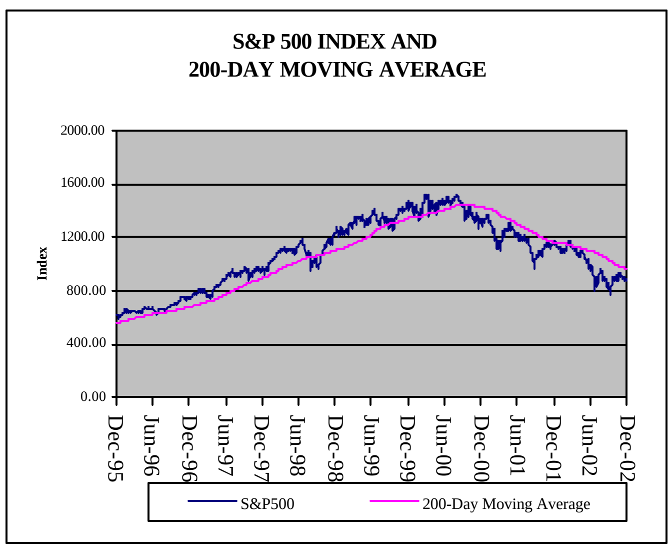
A number of economic indicators experienced erratic performance during October and November. Aggregate labor market conditions as measured by payroll employment weakened in October and November. Private nonfarm payroll declined in November after making modest gains during the third quarter and into October but remained below the level at the beginning of the year. Industrial production declined in October followed by a modest increase in November yet both months were below the levels experienced during the first three quarters of 2002. Seasonally adjusted retail sales excluding food services increased modestly during October and November after a significant weakening in September. Starts of housing units declined in October and November to modest levels after a sixteen-year high in September.

Buoyed by mortgage rates near historical lows, sales of new one-family homes increased 5.7 percent on a seasonally adjusted basis in November after a 4.0 percent decrease in October, but sales of existing single-family homes decreased 3.5 percent in November following a 5.9 percent increase in October. Home prices continued to increase during October and November with November median price 9.7 percent above November 2001. New orders for nondefense capital goods excluding aircraft decreased 2.7 percent on a seasonally adjusted basis in November following a 5.4 percent increase in October. This lack of sustainable growth in a number of economic indicators suggests that the overall economic activity in the near term will remain sluggish and real gross domestic product will be lower in the fourth quarter compared to the 4.0 percent real growth during the third quarter.

Consumer attitudes, whether measured by the Conference Board's consumer confidence index or the University of Michigan's consumer sentiment index, declined during the third and fourth quarters of 2002. After posting gains during the first quarter of 2002 and remaining relatively flat during the second quarter, the consumer confidence index declined in October to its lowest level in 2002, rebounded briefly in November, declined in December. The University of Michigan's consumer sentiment index experienced a similar trend declining in October to its lowest level since September 1993 but rebounded slightly in November and December. Investors do not favor a drop or erratic pattern in the indices because such declines portend consumer pessimism and reduced spending. A reduction in spending means lower corporate revenues and hence lower earnings in the near term without a concomitant reduction in costs.

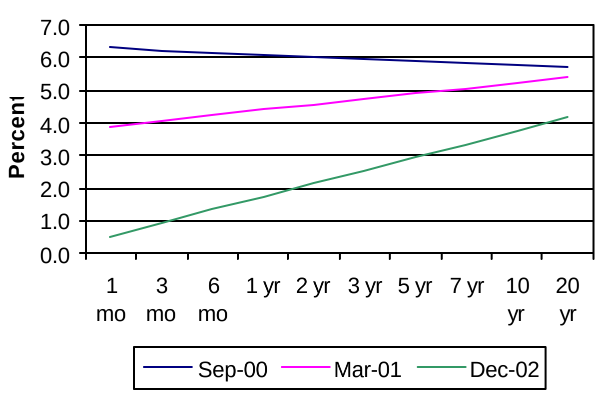
Because of potential weak consumer sentiment, weak global demand, geopolitical risks, and excess capacity, corporations are hesitant to expand their operations and instead are cutting costs rather than raising prices in order to meet earnings expectations. Such cost reductions include trimming payrolls. According to *Business Week* estimates, companies that comprise the S&P 500 may cut as many as 900,000 jobs (or 4% of their workforce and 0.7% of total payroll employment) during the next year to boost operating profits by 12 percent. If corporations undertake such cost cutting measures, total payroll employment will be less than 130 million for the first time since October 1999.

The U.S. financial markets experienced two opposite yet significant trends during the third and fourth quarter and for the entire year. While the stock market continued its bear market during 2002 creating a decline in capital gains, interest rates continued to reach historic lows buoying the residential housing market. Not surprisingly, the stock market continued to be a bellwether of weak business and consumer attitudes. According to a report by Standard & Poor's, the close of 2002 "continued a three-year trend of negative returns for the S&P 500 which had a total capital loss of 40.1 percent over the period." The last three-year downturn occurred between 1939 and 1941 with a 34.2 percent loss. However, the recent bear market follows on the heels of one of the best three-year periods for the S&P 500 index, which gained 98.4 percent between 1997 and 1999. For the year of 2002, the S&P 500 had its worst year (-23.4%) since 1974, and stocks lost $2.41 trillion in 2002 and $4.27 trillion since year-end 1999. For the fourth quarter, December's loss of 6.0 percent was the largest since December of 1931 (-14.5%).



However, while the economic situation during the third quarter and part of the fourth quarter was sluggish, the future economic outlook appears a bit more optimistic. Such optimism is based on the record low interest rates and the accommodative policy of the Federal Reserve over the past two years. A leading indicator of future economic activity is the term structure of interest rates or yield curve of U.S. Treasury securities. The yield curve represents a spectrum of interest rates for different Treasury securities ranging from one month to twenty years. The accompanying chart illustrates yield curves for three periods: September 2000, March 2001, and December 2002. The yield curve for September 2000 sloped downward indicating that the economy was about to experience a downturn. In fact, the latest recession began six months later on March 2001. Once the recession appeared imminent, the Federal Reserve began a series of interest rate cuts starting with a 50 basis point reduction in the federal funds rate on January 3, 2001 followed by two more 50-basis-point cuts on January 31 and March 20, respectively. The effects of the rate cuts changed the slope of the yield curve dramatically such that it turned upward by March 2001. Further rate cuts throughout 2001 and 2002 created a steeper slope to the extent that by December 2002 the yield curve indicated a continued mild economic expansion into the first quarter of 2003.

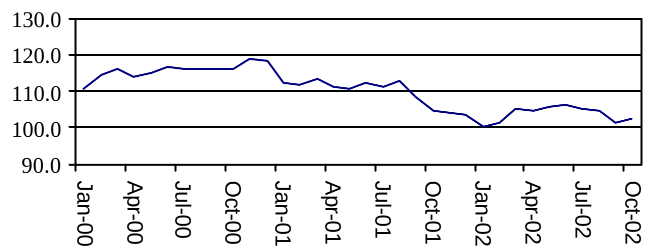
YIELD CURVES FOR TREASURY SECURITIES



SOURCE: U.S. Department of the Treasury

The regional economy weakened substantially during the third quarter but recovered slightly during October. Of the four variables that constituted the regional coincident index, three declined during the third quarter: consumer confidence (-23.4%), employment (-1.2%), and sales of nondurable goods (-6.5%). Only domestic airport passengers increased (1.8%). The third quarter decline was the first since the fourth quarter of 2001 and indicated that the regional economy experienced little or no growth.

COINCIDENT INDEX
WASHINGTON MSA



SOURCE: Center for Regional Analysis, George Mason University

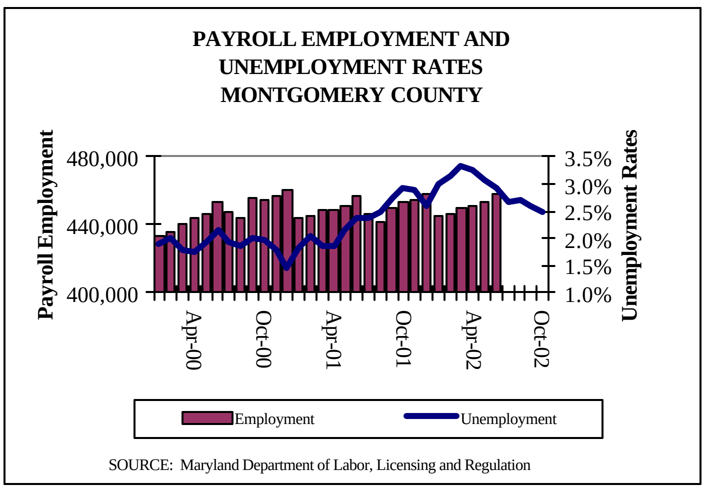
MONTGOMERY COUNTY ECONOMIC INDICATORS

Montgomery County's economy exhibited mixed results during the third quarter and into the first two month of the fourth quarter. The County's unemployment rate continued to decline from its recent peak in March and April of this year. However, growth in payroll employment remained sluggish and a drag on the local economy. Coupled with the bull market, the lack of growth in private-sector payroll employment in 2001 and 2002 has had a negative effect on the County's income tax revenues.

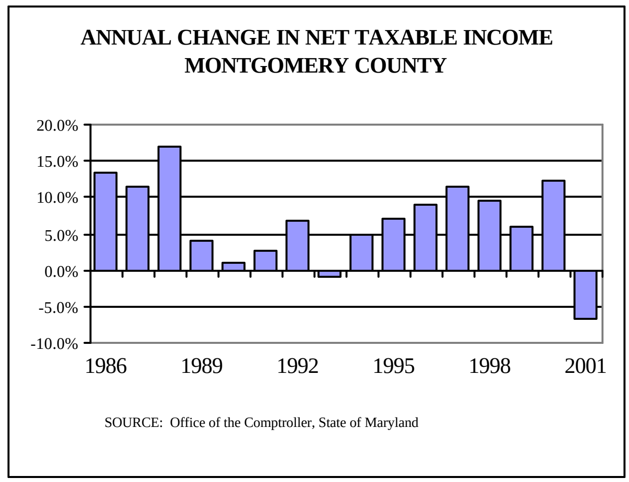
Housing sales declined during the third quarter and the first two months of the fourth quarter but house prices continued to make remarkable gains with median prices increasing 19.3 percent during 2002. Retail sales during the third and early fourth quarters exhibited mixed results. Total sales in the County increased only 0.9 percent during the first ten months of 2002.

The outlook for the region's economy suggests an uneven expansion during the fourth quarter and into the first quarter of 2003. The region's economic leading indicators declined in October to its lowest level since October of last year. Rebounds in consumer sentiment, employment, and sales of nondurable goods are necessary for further growth.

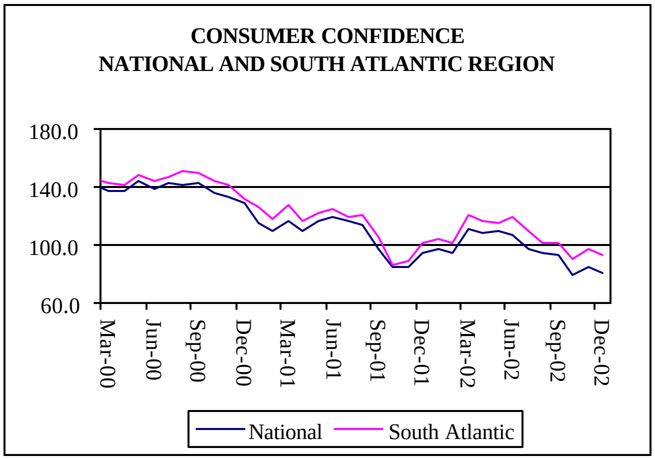
During the first half of 2002, payroll jobs in the County averaged 450,820 compared to 448,854 over the same period in 2001, an increase of 0.4 percent. The increase is attributed primarily to the government sector, which grew 3.1 percent while jobs in the goods producing sector increased 0.6 percent and jobs in the services sector declined 0.1 percent. The unemployment rate declined to 2.5 percent in October 2002.



The effects of the weak employment situation and the significant decline in the stock market had a significant impact on net taxable income in 2001, which declined 6.7 percent and was the first decline since 1993 and the largest on record. While the recession and its effect on employment was part of the reason for the decline, the major contributor was the decline in capital gains. Comparing the change in net income in 2001 to the recession of 1990-91, net taxable income actually increased, although modestly, during that recession. Such a comparison suggests that the dramatic decline in net taxable income in the County is primarily due to an estimated 60 percent drop in capital gains for Montgomery County residents in 2001.



Consumer confidence turned pessimistic in the region during the third and fourth quarters of 2002. The regional indicator declined 22.5 percent during the second half of 2002 compared to the second quarter. While such confidence can be attributed to a number of non-economic factors, such as the war against terrorism, the major contributors are the employment outlook and the stock market. Over 80 percent of the respondents expressed concerns about the job market. Declining consumer confidence threatens consumer spending which has been the significant driver in the economic expansion.

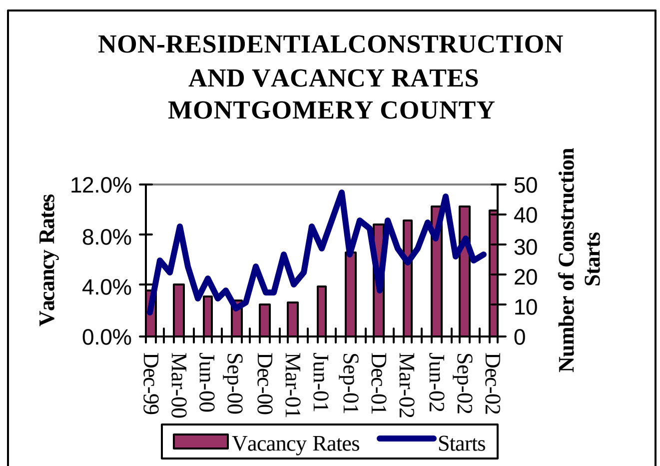


While construction of non-residential property continued its remarkable pace during the third and fourth quarters, vacancy rates for office space remained at historically high levels in the County. If vacancy rates remain at such levels, new construction starts for non-residential property should decline dramatically so that the vacancy rate meets its recent average of 4.2 percent.

Non-residential construction in the County continued to grow with 104 new non-residential construction projects started during the third quarter, up slightly from the second quarter and the second highest during the past three years. The recent boom in non-residential construction occurred mostly in new office space adding approximately 273,000 square feet and $31.1 million in value during the third quarter. Other sectors that added capacity during the third quarter included stores and food service facilities with 130,000 square feet valued at $17.0 million, warehouses with 235,000 square feet valued at $7.5 million, garage and service stations with 287,000 square feet valued at $16.4 million, medical facilities with 104,000 square feet value at $7.1 million, and education facilities with 10,000 square feet of new construction.

With the recent expansion, vacancy rates in the County have risen since the construction boom began. Although lower than some jurisdictions in the Washington area, the rate increased from a low of 2.5 percent in December 2000 to 9.9 percent by December 2002. This reflects an inventory of approximately 3.1 million square feet of vacant office space. Compared to other local jurisdictions, Fairfax County has a vacancy rate of 13.8 percent with approximately 9.3 million square feet of vacant office space, the City of Alexandra and Arlington County have a vacancy rate of 10.1 percent with approximately 2.4 million square feet of vacant office space, and the District of Columbia has a vacancy rate of 6.1 percent with approximately 3.6 million square feet of vacant office space. Such an increase suggests that non-residential construction will slow in order to balance supply with demand.

While the office vacancy rate for the Washington metropolitan area has steadily increased over the past year, it remains below the rates of other major metropolitan areas throughout the country. According to Delta Associates, the Washington area vacancy rate was 8.1 percent during the third quarter compared to 11.4 percent for Los Angeles and Orange County, 12.1 percent for the Chicago area, 12.3 percent for Houston, 12.6 percent for Denver, and 15.2 percent for Phoenix.

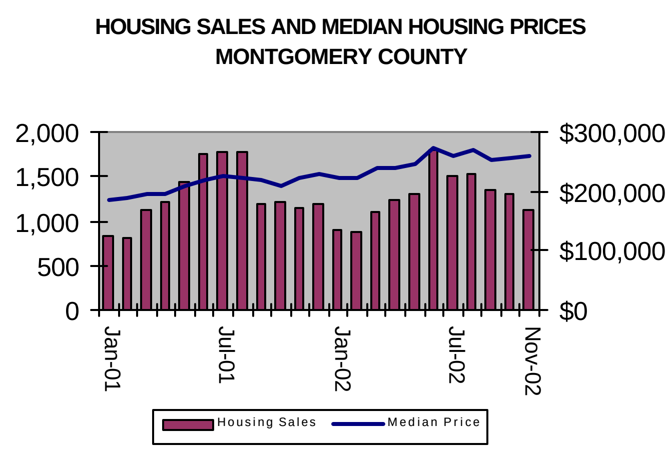


SOURCES: Dodge Analytics and MNCPCC

During the third quarter and the first two months of the fourth quarter, housing sales in the County decreased 0.4 percent compared to the same period in

2001. For the eleven months of 2002, housing sales decreased 2.1 percent compared to the first eleven months of 2001. While given the attention the real estate market in the Washington area received in the local and national financial and daily news media, such declines seem counterintuitive. However, sales in 2002 follow a strong 2001, which was remarkable given the recession. The drop in the third quarter and first two months of the fourth quarter is attributed to the decline of 590 units in July, August, and November compared to strong sales during the same months of 2001.

The strength of the real estate market in the County has been the rapid increase in home prices. Median prices during the third quarter and first two months of the fourth quarter rose a remarkable 17.8 percent compared to the same period in 2001 and 19.3 percent year to date. This rate follows a 10.2 percent increase during the first eleven months of 2001. Home prices in the County have appreciated at least 30 percent over the last two years and support the sharp rise in recent reassessments.



SOURCE: Metropolitan Regional Information System

Retail sales for the County as measured by sales tax receipts increased 0.5 percent during the third quarter and October of 2002 compared to the same period in 2001. However, during the first ten months of 2002, sales increased only 0.9 percent compared to 4.4 percent during the first ten months of 2001, the recession period. The slowdown was primarily attributed to a decline in apparel items, furniture and appliances, and hardware and machinery.

Overall inflation in the Washington region remained quiescent during 2002 although slightly above the national average. Overall prices did not increase between September and November of 2002. For the twelve-month period ending in November, prices increased 2.3 percent in the region compared to 1.5 percent for the nation. The difference is attributed to a higher core inflation rate caused by the rapid increase in housing costs that have been running at 5.1 percentage points for the year and medical services that have been running at 3.4 percent for the year. These two factors along with energy prices are expected to increase significantly into the early part of 2003.

SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date 2002	Year To-Date 2001	2001
Leading Indicators						
National	November	0.7%		2.4%		2.5%
Washington MSA	October	-0.6%		0.6%		-0.9%
Consumer Confidence Index						
National	December	-5.4%		-15.1%		-26.4%
South Atlantic Region	December	-4.9%		-7.9%		-23.9%
Consumer Price Index						
All Items						
National	November	2.2%		1.5%		2.9%
Washington - Baltimore CMSA	November	2.8%		2.3%		2.6%
Core CPI						
National	November	2.0%		2.4%		2.7%
Washington - Baltimore CMSA	November	2.4%		3.0%		3.1%
Retail Trade						
National (sales)	November	1.4%		3.2%		3.7%
Maryland (tax)	October	-4.6%		1.6%		3.0%
Montgomery County (tax)	October	-6.1%		0.9%		3.8%
Employment						
National	November	134,358,000	134,359,000	134,272,091	135,108,727	135,073,000
- Percent Change		0.0%		-0.6%		-0.1%
Washington PMSA (at place)	October	2,795,700	2,815,000	2,786,800	2,788,900	2,831,800
- Percent Change		-0.7%		-0.1%		2.8%
Montgomery County (resident)	October	491,529	480,102	486,808	477,872	477,701
- Percent Change		2.4%		1.9%		0.7%
Montgomery County (payroll)	June	457,946	456,983	450,944	449,003	447,744
- Percent Change		0.2%		0.4%		4.9%
Unemployment						
National	November	5.7%	5.3%	5.8%	4.7%	4.8%
Maryland	October	3.8%	4.3%	4.5%	4.0%	4.1%
Washington PMSA	October	3.3%	3.8%	3.7%	3.0%	3.1%
Montgomery County	October	2.5%	2.9%	2.9%	2.3%	2.3%
Construction						
Project Cost - Montgomery County						
Total ($ thousand)	November	$110,106	$143,490	$1,399,939	$1,386,057	$1,353,664
- Percent Change		-23.3%		1.0%		15.4%
Residential ($ thousand)	November	$48,444	$83,751	$640,826	$740,650	$682,768
- Percent Change		-42.2%		-13.5%		17.2%
Non-Residential ($ thousand)	November	$61,662	$59,739	$759,113	$645,407	$670,896
- Percent Change		3.2%		17.6%		13.6%
Building Permits (Residential)						
National	November	124,513	118,357	1,593,578	1,500,974	1,610,766
- Percent Change		5.2%		6.2%		1.2%
Maryland	November	2,105	2,252	26,241	26,545	28,412
- Percent Change		-6.5%		-1.1%		-6.4%
Montgomery County	November	405	393	4,049	4,701	5,091
- Percent Change		3.1%		-13.9%		13.8%
Building Permits (Non-Residential)						
Montgomery County	November	145	139	1,735	1,954	2,102
- Percent Change		4.3%		-11.2%		23.9%
Real Estate						
National						
Sales	November	5,560,000	5,250,000	5,580,000	5,300,000	5,296,000
- Percent Change		5.9%		5.3%		2.8%
Median Price	November	$161,400	$147,100	$157,400	$145,900	$147,800
- Percent Change		9.7%		7.9%		6.3%
Montgomery County						
Sales	November	1,115	1,186	14,023	14,318	15,489
- Percent Change		-6.0%		-2.1%		4.8%
Average Price	November	$318,518	$280,962	$315,525	$273,159	$274,522
- Percent Change		13.4%		15.5%		8.1%
Median Price	November	$260,000	$225,000	$249,268	$208,936	$215,000
- Percent Change		15.6%		19.3%		13.2%

METROPOLITAN AREA OFFICE MARKET

Office Vacancy Rate by Jurisdiction and Class, 12/02

Jurisdiction	Class A	Class B	Class C	Total
Loudon	14.5%	19.6%	11.7%	15.9%
Fairfax	13.8%	11.5%	8.4%	13.1%
Frederick	3.8%	18.8%	11.1%	9.5%
Alexandria/Arlington	10.1%	17.0%	3.6%	11.5%
Montgomery	***9.9%***	***8.3%***	***13.0%***	***9.7%***
District of Columbia	6.1%	4.2%	3.6%	5.1%
Prince George's	8.2%	9.2%	9.5%	8.8%
Metropolitan Area	10.1%	9.2%	6.7%	9.5%

Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudon	822,844	513,837	48,467	1,385,148
Fairfax	9,297,480	2,712,755	218,932	12,229,167
Frederick	78,918	228,922	37,878	345,718
Alexandria/Arlington	2,361,812	2,692,360	247,015	5,301,187
Montgomery	***3,068,474***	***1,704,282***	***857,397***	***5,630,153***
District of Columbia	3,566,112	1,722,329	447,723	5,736,164
Prince George's	761,370	498,472	361,394	1,621,236
Metropolitan Area	19,957,010	10,072,957	2,218,806	32,248,773

Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudon	5,664,653	2,623,228	414,970	8,702,851
Fairfax	67,461,664	23,518,868	2,592,999	93,573,531
Frederick	2,073,049	1,217,234	341,504	3,631,787
Alexandria/Arlington	23,369,493	15,864,976	6,855,136	46,089,605
Montgomery	***30,845,228***	***20,601,666***	***6,603,090***	***58,049,984***
District of Columbia	58,443,735	40,664,962	12,411,725	111,520,422
Prince George's	9,231,739	5,401,956	3,815,203	18,448,898
Metropolitan Area	197,089,561	109,892,890	33,034,627	340,017,078

Share of Office Space Inventory by Jurisdiction and Class

Jurisdiction	Class A	Class B	Class C	Total
Loudon	65.1%	30.1%	4.8%	100.0%
Fairfax	72.1%	25.1%	2.8%	100.0%
Frederick	57.1%	33.5%	9.4%	100.0%
Alexandria/Arlington	50.7%	34.4%	14.9%	100.0%
Montgomery	***53.1%***	***35.5%***	***11.4%***	***100.0%***
District of Columbia	52.4%	36.5%	11.1%	100.0%
Prince George's	50.0%	29.3%	20.7%	100.0%
Metropolitan Area	58.0%	32.3%	9.7%	100.0%

Note: Office Space inventory includes leasable and owner-occupied space.
Totals exclude non-classified space.
Vacant means "direct vacant" and does not include sublease space.

Source: Montgomery County Department of Planning, Research and Technology Center
Data compiled from Realty Information Group commercial space data file, 12/19/02